North Dakota State Investment Board

September 2003



# **HOW DO WE MEASURE UP?**

Do you know how the Teachers' Fund for Retirement (TFFR) and the Public Employees Retirement System (PERS) manage their investment programs?

It is probably a good guess to assume that you know the answer is, "yes, the State Investment Board (SIB) takes care of it." This is true, and leads to another question. "If the SIB uses the same asset classes and investment managers for both pension funds and virtually all of the investments are pooled together, why does the return over any given period differ between TFFR and PERS?" If you are a regular reader, then two words have already popped into your mind... asset allocation.

TFFR and PERS use the same ten asset classes. In some cases, such as stocks of American companies, they slice up the investable universe into "Large Cap" (big companies) and "Small Cap" (small companies). And just to keep you on your toes, they call stocks, "equities." The same thing happens with bonds (fixed income) and other highly defined asset classes, but in the final analysis, you can boil it down to two major categories: equities and fixed income. Exhibit 1 below shows the ten asset classes used and which major category they fall into.

For reasons specific to the individual funds (as explained in previous

newsletters), TFFR and PERS have different percentages of their funds invested in most of the asset classes shown. If you think in a macro sense, the result is that the equity-to-fixed income ratio for each fund is different. So, essentially, when stocks do better than bonds, the fund with more stocks relative to bonds performs better and vice versa.

The job of the SIB is to try to have good performance within each of the asset classes, while keeping risk under control. We have our share of tough times, but we use an independent consultant to monitor performance and report on how our results stacked up against other public pension funds. Of course, to unintentionally complicate the matter, they categorize things just a little differently. For example, instead of reporting Large Cap Domestic Equity and Small Cap Domestic Equity separately, they combine them into Domestic Equity. The same goes for other asset classes, but virtually all of the assets are accounted for, just sliced up a little differently. Exhibit 2 (inside) is the consultant's report on how our performance ranked by asset class for fiscal year 2003.

Continued inside...

### **State Investment Board**

Lt. Governor Jack Dalrymple, *Chair*Weldee Baetsch, Brent Edison,
Kathi Gilmore, David Gunkel, Paul Lofthus,
Jim Poolman, Gary Preszler, Howard Sage,
Mark Sanford, Norman Stuhlmiller

# **RIO Administrative Office**

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Articles are for general information only and are not intended to provide specific advice or recommendation. Other forms of this newsletter are available on request.

## **EXHIBIT 1**

Equities	Fixed Income	
Large Cap Domestic Equities	Domestic Fixed Income	
Small Cap Domestic Equities	High Yield Fixed Income	
International Equities	International Fixed Income	
Emerging Market Equities	Real Estate	
Private Equity	Cash Equivalents	

Steve Cochrane, CFA Executive Director/CIO

# Certificate of Achievement for Excellence in Financial Reporting Presented to North Dakota Retirement and Investment Office For its Comprehensive Annual for the Fiscal Year Ended June 30, 2002 A Certificate of Achievement for Excellence in Financial Reporting by presented by the Government Finance Offices Reporting by foresting the presented by the Government Finance Offices Reporting by presented the finance of Financial Reports (CAFRO) and Camada in South Financial Reports (CAFRO) and Camada financial reports (CAFRO) and Camada financial reports (CAFRO) and Each Bull March Standards in government under accounting and financial reporting. President March Executive Director

# FROM THE DIRECTOR'S CHAIR

Have you ever pulled up the page on our website that shows investment performance and portfolio composition? If you have, you may have noticed something a bit unexpected... timberland holdings in our Domestic Fixed Income asset class. What are trees doing in the middle of a bunch of bonds? Growing! Believe it or not, there is a method to the madness. Outside of the fact that every physical bond began life as a tree, there are actually some scientifically based statistical justifications that can be identified to support this structural conclusion.

The thought of investments in timberland often brings one image quickly to mind... the sight of the Western forestlands going up in smoke! Well, we could fill up an entire newsletter on the issue of forest management, but that would be outside the scope of this discussion. In fact, fire is not the only danger to forests; we also need to consider the risks. There are biological risks such as fire, insects, disease and wind damage. Financial risks involve the illiquidity of the asset and the fact that timber prices fluctuate. And, we can't forget regulatory risk, such as laws enacted to protect wildlife species on public lands.

We have effectively addressed these risks by concentrating our investments in Southern managed softwood (primarily pine) plantations. Our holdings are geographically dispersed to further reduce risks. According to industry studies, biological risk factors have historically impacted less than 0.2% of timber stands of this type. Most of the forest lands in the South are privately owned and not subject to the regulations placed on public lands. And of course, these are not "wild forests" subject to exceedingly hot, widespread fires.

Our trees are professionally maintained using the latest technologies available in modern forest management. They are, in effect, grown as "crops." They begin life as genetically engineered saplings, planted in rows according to highly defined specs on prepared lands, fertilized, protected with manmade and natural firebreaks, monitored regularly, treated with insecticides and herbicides, and eventually harvested. The nice thing about trees, though, as opposed to wheat, for example, is that they don't have to be harvested in any particular season. So if the market is soft at any point, there is no need to cut down the trees and sell them cheaply. We just continue to "store them on the stump" and wait for the market conditions to improve. In the meantime, these babies just keep on growing, over a lifetime averaging 8% or more biological growth per year.

Another attractive feature is that trees don't care if the stock market crashes or we are hit with another major terrorist strike. They grow, oblivious to all of our global concerns, out there in the Southern woodlands, where the risks are low and the trees grow tall towards the sky!

# ACHIEVEMENT AWARD RECEIVED

The ND Retirement and Investment Office (RIO) is pleased to announce that its Comprehensive Annual Financial Report (CAFR) for June 30, 2002 has qualified for a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA).

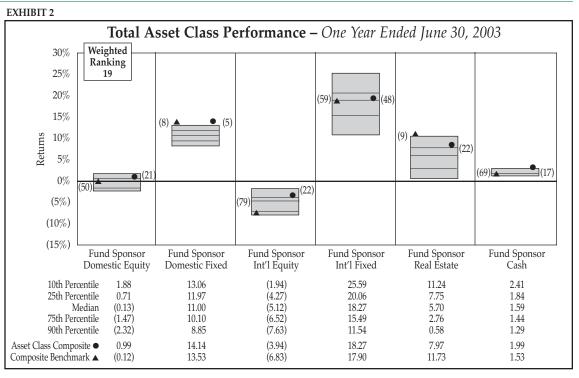
The Certificate of Achievement is the highest form of recognition in public employee retirement system accounting and financial reporting, and its attainment represents a significant accomplishment. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

# HOW DO WE MEASURE UP? Continued from front cover

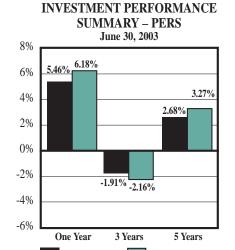
This is called a "floating bar chart." The vertical axis shows investment rates of return while six asset classes are plotted on the horizontal axis. The space taken up by each bar represents the range of returns for managers in the database. The diamond shape on the left side of each bar is how the relevant benchmark performed for the one year period ending June 30, 2003. The circle shape is how the SIB portfolio ranked within the universe. Each shape has an associated number ranking. For example, in the first category, Domestic Equity, our portfolio outperformed the benchmark

by more than 1% and ranked in the top 21% of all funds in the database. Each bar reads similarly, so you can quickly scan the data for some good information. Overall, you can see that the relative performance has been very good. In fact, in five out of six asset classes, our returns were in the top quartile of all public funds in this database. Only International Fixed Income failed to reach that height, settling instead for a better than average 48th percentile. In an effort to improve performance potential in this asset class, the SIB recently added a second manager.

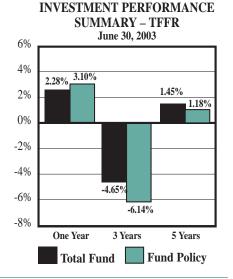
So, what does all this have to do with TFFR and PERS, anyway? Well, as you can imagine, both of the pension funds participate in each of these asset classes. The unique asset allocation for each fund drives their exposure to each asset class. Depending on which markets are doing well or poorly over any given period, the fund will reflect the results in its performance. Overall, the TFFR has more of its plan invested in stocks than PERS does. So, basically, when bonds do better than stocks, PERS does better than TFFR. Notice in Exhibit 2 how much better the fixed income asset classes did than the equity classes. And that's the story of fiscal year 2003.



# **INVESTMENT PERFORMANCE**



**Total Fund** 



# TARGET ASSET ALLOCATION FOR PERS & TFFR

Fund Policy

Period Ended June 30, 2003

ASSET ALLOCATION	% OF TOTAL, PERS	% OF TOTAL, TFFR
Domestic Large Cap Equity	30.0%	30.0%
Domestic Small Cap Equity	10.0%	10.0%
International Equity	10.0%	20.0%
Emerging Markets Equity	5.0%	5.0%
Domestic Fixed Income	24.0%	7.0%
High Yield Fixed Income	5.0%	7.0%
International Fixed Income	5.0%	5.0%
Real Estate	5.0%	9.0%
Private Equity	5.0%	5.0%
Cash Equivalents	1.0%	2.0%
Total Fund	100.0%	100.0%

# SIB ELECT OFFICERS

The State Investment Board (SIB) recently held its annual election of officers. The SIB chose the following members to hold leadership positions for the 2003-2004 fiscal year:



Chairman Lt. Governor Jack Dalrymple



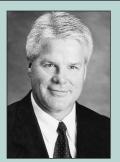
Vice-Chair Howard Sage



Parliamentarian Norm Stuhlmiller

Visit our website for information from the North Dakota Retirement and Investment Office...

www.discovernd.com/rio



Brent Edison
Workforce Safety
and Insurance



Rebecca Dorwart MDU Resources

# SIB AUDIT COMMITTEE APPOINTED

The five member SIB Audit Committee has a couple of new faces in 2003-04. Brent Edison, Executive Director of Workforce Safety & Insurance has replaced State Treasurer Kathi Gilmore, and Rebecca Dorwart of MDU Resources has replaced Daryl Splichal. The remaining members of the committee are Norm Stuhlmiller, TFFR Board member; David Gunkel, PERS Board member; and Korrine Lang, Job Service North Dakota.

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